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C O N F I D E N T I A L SECTION 01 OF 03 LA PAZ 000462

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SUBJECT: BOLIVIAN GAS: BEGGAR THY NEIGHBOR

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Classified By: A/DCM Mike Hammer for reasons 1.4 (b) and (d).

Summary

¶1. (SBU) Bolivia is struggling to cope with stagnant national gas production, increased contractual obligations, and growing domestic demand. In an effort to largely allay Argentinean fears of energy shortfalls over the winter months, President Morales met with the Presidents of Brazil and Argentina on February 23 to try to convince Lula to reduce the amount of gas being sent to Sao Paulo in order to increase what it sends to Argentina. The meetings yielded no gas concessions; rather, Brazil promised to analyze the possibility of sending electricity to Argentina during moments of critical need. The energy ministers from the three nations will meet again in March to attempt to further "coordinate actions," but considering the current energy realities in the Southern Cone these meeting will likely yield few results. End Summary.

The Bolivian Reality

¶2. (U) Current Bolivian production of gas hovers around 40 million cubic meters of gas per day (Mm3/d). Bolivia's contractual obligations total more that 46Mm3/d. Bolivia will not have the gas to fulfill these contract through 2008 and is unlikely to have sufficient production in 2009. Bolivia has already cut gas entirely for contracts to supply an electrical plant in Cuiaba Brazil (1.1Mm3/d) and with Comgas (.6Mm3/d) in Sao Paulo. The principal contract with Brazil, the Gas Sales Agreement (GSA), is the only contract being fully met. It requires that 30Mm3/d be delivered to Sao Paulo (Note: In order to deliver this quantity, over 31Mm3/d needs to be placed in the pipeline. End note.) After

fulfilling the GSA, Bolivia is left with less that 9Mm3/d, and this is divided between domestic users (around 6Mm3/d) and Argentina.

The Contract with Argentina

¶3. (C) The contract with Argentina is a "ramp-up" contract which increased the amount of gas Bolivia should supply to Argentina this year to 7.7Mm3/d (up from 4.6Mm3/d in 2007). Moreover, it further increases commitments to 27.7Mm3/d in ¶2010. Bolivia will clearly need to renegotiate this contact and has already publicly admitted as much. The real pending issue is if Argentina will push to collect on rather strict "delivery of pay" portions of the contract. Late last year Argentina did bill the Bolivia government US$10 million for violating the terms of the contract. According to Martin Recondo, who manages the gas portfolio at the Argentine Embassy in La Paz, this bill is "working its way through the channels," but in truth he admits that the political will to fully execute the terms of the contract does not exist. Moreover, he reports that the Argentine Embassy in La Paz is not very involved in the negotiations, rather the Argentine State Hydrocarbon Company (ENARSA) and the Energy Ministry are taking the lead. Bolivian officials argue that, according to the contract, the quantities of gas piped to Argentina need to be "confirmed" by the Bolivian State Hydrocarbon Company (YPFB). If the quantities of gas sent are not "confirmed" then delivery or pay clauses cannot be enforced. In reading the contract with the Petrobras representative in La Paz, Auturo Castanos, such arguments

seem disingenuous and would be difficult to defend in court. The lack of follow through on the delivery of pay fines is more likely the result of the lack of Argentine political will.

¶4. (C) Recondo also thought that the construction of the proposed new Bolivia/Argentina pipeline (without which the quantities of gas called for in 2010 could not be delivered) would not begin without a significant increase in Bolivian production. Despite this, the bidding process for pipeline construction has gone forward in Argentina, with two bidders on the shortlist.

¶5. (C) Currently Argentina is paying seven dollars per million BTU for Bolivian gas, whereas Brazil pays between $4.50-$5.00. Logic would dictate that as a response to unfulfilled quantities of gas being shipped, Argentina might begin to demand a price discount. Recondo responded to the idea by questioning why logic would apply. However, as Bolivia moves forward in renegotiating the existing contract, price is likely to be on the table.

The Contract with Brazil

¶6. (C) Brazil has more leverage over Bolivia than Argentina. It is telling that there has been no public criticism of Brazil by the government for it's unwillingness to cede any gas to Argentina. The Morales Administration is relying heavily on Petrobras to invest in gas production. Moreover, considering Petrobras represents close to half of all gas produced in Bolivia, the industry looks to the Brazilian company for leadership in the sector. The President of Petrobras, Jose Gabrielli, said that at the moment it is impossible for Brazil to divert even one molecule of Bolivian gas to Argentina. The gas situation in Brazil looks very tight for the upcoming winter (Reftel) and pleading from Evo and calls to be "responsible" by Cristina Kirchner are unlikely to force Lula's hand.

¶7. (C) Additionally, Petrobras Representative Castanos

pointed out that there are serious contractual obstacles to diverting gas from Brazil to Argentina. Not only are there "take or pay" and "deliver or pay" clauses in the GSA contract, there are "transport or pay" clauses as well. These clauses entail that the pipeline operator be paid as if the full volume were transported even if less gas were actually delivered. Bolivia would be hard pressed to pay "deliver or pay" penalties, while also compensating pipeline operators. Furthermore, not that the Morales Administration is particularly averse to hypocrisy, but in the past Bolivia was rigid in applying the "take or pay" clauses on Brazil when it was not prepared to receive minimum shipments of gas.

The Morales Government Response

¶8. (C) In typical fashion, Vice President Linera's response to the contractual bind was to blame the oil companies. He claims they are "defending themselves by halting investments" and that for this reason Bolivia will need to renegotiate with Argentina. According to the Vice President, the administration "gave a strong blow to the oil companies, we whipped them and they resent it." The reality is that Bolivia is suffering from an increasing lack of credibility within the industry and among its neighbors. Not only does a possible new constitution loom over the entire sector, but the official rhetoric continues. Brazil and Chile are both clearly planning on future independence from Bolivian gas, while Argentina stumbles ahead with it's own market distorting policies and looks to cope with the immediate

crisis with increased imports of fuel oil.

Comment

¶9. (C) The future of gas integration in the Southern Cone is not particularly promising. Trust and a history of fulfilled contracts are in short supply. Despite calls for cooperation and a clear economic rational, Bolivia is not a reliable partner. Some of the blame also falls to Argentina, which knew when it signed the "ramp up" contract that Bolivia would be hard-pressed to deliver. As Martin Reconco commented, "the current situation was not hard to imagine." Ironically, the only agreement that came out of the Presidential meetings was to cooperate on the construction of five hydroelectric dams. Despite the announcement, both Brazil and Chile are clearly steering a course for energy self sufficiency. Bolivia, meanwhile, increasingly risks isolation and unsecured markets for its gas.

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